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C O N F I D E N T I A L SECTION 01 OF 02 TOKYO 000100

SIPDIS

TREASURY FOR IA DOHNER, WINSHIP, FOSTER

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TAGS: [ECON](#) [EFIN](#) [JA](#)

SUBJECT: TREASURY VISIT ASSESSES SEVERITY OF JAPAN'S  
ECONOMIC DOWNTURN

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Classified By: Charge d'Affaires James Zumwalt for reasons 1.4 (b) and (d).

11. (C) SUMMARY. Japan's economic recession may turn out to be longer and deeper than the U.S. downturn, Japanese government, academic, and private sector economic and financial experts told Treasury Deputy Assistant Secretary for Asia Robert Dohner. The Japan-based economic analysts explained the export focused manufacturing sector has been hit the hardest, with auto and auto parts manufacturers and consumer electronics companies experiencing the steepest falls in sales and profits. The experts further explained that Japan's political stalemate is severely constricting the Aso Administration's policy options to stimulate the economy and bring Japan out of its first recession since 2002. Policymakers told Dohner that Aso's politically unpopular cash payouts were too small (0.2% of GDP) to stimulate sustainable economic growth. END SUMMARY.

12. (C) Treasury Deputy Assistant Secretary for Asia Robert Dohner, Director of East Asia Christopher Winship, Treasury Markets Room Director Michael Pedroni, and Japan desk officer William Foster met with a wide range of private market participants, public sector officials (including the Ministry of Finance, Bank of Japan, Financial Services Agency and Cabinet Office), academics and politicians (LDP, DPJ, and New Komeito) January 7-10 to assess the extent of the current downturn in the Japanese economy. The primary conclusion from these meetings is that, while the financial crisis primarily originated in the United States, for reasons ranging from export dependency to a limited fiscal response, the recession in Japan may turn out be both deeper and longer than in the U.S.

Recession Likely to be Deeper and Longer than U.S.  
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13. (C) Japan has been in a technical recession since Q3 2008, after registering -3.7% growth in Q2 and -1.8% in Q3. This ended the longest Japanese postwar economic expansion, which while long (dating from Q1 2002) only averaged 2.1% annual real growth. Private sector projections for Q4 2008 growth range from -5% to -10%. By contrast, the weekly consensus compiled by Macroeconomics Advisors puts U.S. real GDP growth in Q4 between -4.0% and -6.2%. While the basis for the figures is somewhat different -- Japan uses a quarter-on-quarter seasonally adjusted annual rate while the

U.S. uses a year-on-year annual rate -- it is nonetheless striking that Japan's economy appears to be contracting at a faster pace than that of the United States.

#### Autos and Manufacturing Driving Japan,s Economy

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14. (C) The reason most often cited during Dohner's meetings was the prominence of manufacturing, particularly the automotive and electronics sectors, in Japanese industrial production and Japan,s continued reliance upon exports. One private sector analyst pointed out that the automotive sector makes up 5% of economic activity in Japan (versus 2% in the United States), and there is a 3.08 multiplier effect on the broader Japanese economy through component supplier relationships. Thus, a drop in automotive activity has a significant negative impact on overall economic output. Illustrating this point is the November 2008 export data: Japanese exports dropped a record 27% in November, with Japanese automotive exports to the United States in particular plunging 44% year-on-year. Industrial production also fell at a record 8.1% seasonally adjusted annual rate in November. The economist also noted that export driven prefectures in Japan had been the top performers up until the summer. Prior to the crash, Nagoya, Miyagi and Northern Fukuoka were among Japan,s best economic centers. Following September, they now each rank at the bottom because of their reliance upon auto and auto parts manufacturing and exports.

#### Employment Holding Up for Now

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15. (C) Employment so far has held up reasonably well, with the unemployment rate at 3.9% in November and far below the

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recent peak of 5.5% in 2002. While the media in Japan has given great attention to a series of layoffs of "dispatched workers" in the automotive and electronics sectors, both private and public sector analysts pointed out that "dispatched workers" make up a small part of Japan's overall work force -- 1.3 million employees in a labor force of 51.7 million in the labor force -- and "dispatched workers" provide the labor flexibility distressed firms need in the current economic climate. However, the images over the New Year's Holiday of laid-off temporary employees in a tent village in Tokyo's downtown Hibiya Park jarred the Japanese public, furthering the sense of crisis.

16. (C) Consumption, which accounts for 55% of Japanese GDP, has in the words of one private analyst "hit a wall." The Cabinet Office's measure of consumer confidence hit a record low for the second consecutive month in November and households are postponing spending amid economic uncertainty. (NOTE: Retail sales fell 0.9% year-on-year in November for the third straight monthly decline.)

#### GOJ Stimulus Plan Insufficient?

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17. (C) GOJ officials explained the measures they have taken so far, noting that the government expects the three economic policy packages combined (one under former Prime Minister Fukuda and two under current Prime Minister Aso) to add about one percentage point to GDP growth in FY09. However, the same officials stressed the constraints that Japan's gross debt to GDP ratio (173% in 2008) placed on further fiscal measures.

18. (C) Specifically, the government estimated that its plan to make cash benefit payments to households would constitute 0.2 percentage points of the aggregate one percentage point contribution to GDP from the three policy packages. Nation-wide polls show the payments to be politically unpopular (Asahi polling shows 63% of Japanese believe the payments are not necessary, while an NHK poll showed 81% of

Japanese believe the payments will be ineffective to boost the economy). The plan is now a major topic of political debate in the Diet, with discussion focusing on the policy's shifting rationale (from high oil prices originally to recession today), the lack of an income ceiling, and whether the Prime Minister himself would actually collect his payment. This debate frustrated several private analysts, who noted how small the plan is relative to what has already been done in the United States (the U.S. plan was about one percent of GDP). One analyst notably complained that the political establishment was arguing over "irrelevant details of an insufficient plan."

19. (C) Comment. The Aso Administration's inability - whether real or perceived - to take more decisive action to boost the economy has resulted in a familiar attitude of waiting for growth in the United States to lift Japan through exports. Whether speaking to market participants, government officials, or politicians, there is as yet little evidence, even in the face of a sharp contraction, that Japan will seriously rethink its growth model to depend less on external demand and more on private-sector led domestic demand. Dohner's discussions with the DPJ further indicate an opposition with more ambition than fresh thinking regarding economic policy.  
ZUMWALT